

Regional Technical Coordinator
Midwest Region

Assistant Chief Counsel (Income Tax & Accounting)
CC:IT&A:01

Technical Coordination Report Submitted By:
Mr. Theodore D. Olstad
District: Fargo

Recommendation: That section 6701 of the Internal Revenue Code be amended so that the penalty described therein is imposed on any person whose failure to properly prepare or present any portion of a return, affidavit, claim or other document has the result of producing an understatement in another person's tax liability.

The problem uncovered by Mr. Olstad involves the failure of some taxpayers to issue a Form 1099 with respect to certain amounts earned by a payee but not paid in full to such payee. The amounts, if paid in full, would equal or exceed \$600 and therefore clearly require the filing of Form 1099 under section 1.6041-1(a)(2) of the Income Tax Regulations. However, the payor taxpayer, presumably at the request of the payee, divides the total amount into two or more portions, each equalling less than \$600. Each portion is then paid to different persons usually consisting of members of the payee's family. Because each portion thus paid is less than \$600, Forms 1099 are not issued. Mr. Olstad believes an amendment to section 6701(a) of the Internal Revenue Code, imposing a \$1,000 penalty for the failure to issue a Form 1099, is the appropriate way to deal with this problem.

We agree Mr. Olstad has uncovered a tax abuse problem. We also agree that section 6701(a) of the Code, in its present form, does not apply to a failure

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to issue Forms 1099. Section 6701(a) does not apply because the language in it referring to the preparation or presentation of any portion of a return, affidavit, claim, or other document requires the presence of documents whereas a failure to issue Forms 1099 results in an absence of documents. However, we do not believe that amending section 6701(a) is the appropriate way to deal with this problem.

Sanctions already incorporated into the Code other than those provided by section 6701 may be applied to evasions of this type.

Section 6721(a) of the Code imposes a penalty on a person for each failure to file an information return (which would cover Form 1099) with the Internal Revenue Service on or before the required filing date. Section 6721(e) provides, generally, that for each failure due to intentional disregard of the filing requirement, such penalty shall be \$100 or, if greater, 10 percent of the aggregate amount of the items required to be reported correctly.

Section 6722(a) of the Code imposes a penalty on a person for each failure to furnish a payee statement (which would cover the payee copy of Form 1099) on or before the prescribed date to the person required to receive it. Section 6722(c) provides, generally, that for each failure due to intentional disregard of the requirement to furnish a payee statement, such penalty shall be \$100 or, if greater, 10 percent of the aggregate amount of the items required to be reported correctly.

Since the type of problem uncovered by the report involves intentional disregard, sections 6721(e) and 6722(c) of the Code would apply. For each failure, the amount of the penalty itself under these sections (\$100 or 10 percent of the aggregate amount of the items required to be reported) is not insignificant. Moreover, because the penalties provided by sections 6721(e) and 6722(c) can be used together to impose two penalties (for the failure to file and for the failure to furnish a payee statement) with respect to an amount owed to one payee, the amounts imposed under these two sections can be substantial, especially in relation to the amount of the unreported payments. Consequently, the possibility of these penalties being applied should have a deterrent effect on payor taxpayers.

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contemplating aiding payees to evade reporting amounts that should be paid to them.

If sections 6721(e) and 6722(c) of the Code do not provide a sufficient deterrent, section 7203 may be applied. Section 7203 provides, in general, that any person required to make a return or supply information, who willfully fails to make such return or supply such information at the time required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$25,000 (\$100,000 in the case of a corporation), or imprisoned not more than 1 year, or both, together with costs of prosecution.

We appreciate Mr. Olstad's interest and initiative in submitting this Report. Copies of this memorandum are enclosed for the Regional Technical Coordinator, Mr. Olstad, and other interested parties.

(signed) John M. Coulter, Jr.

Glenn R. Carrington
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(Income Tax & Accounting)